

GILBERT ASSOCIATES, INC.

Review Report

QUALITY CONTROL REVIEW

For the Firm's Audit of
Berkeley Unified School District
for the Fiscal Year Ended June 30, 2002



STEVE WESTLY
California State Controller

February 2005



STEVE WESTLY
California State Controller

February 11, 2005

Mr. Thomas Gilbert
Gilbert Associates, Inc.
2880 Gateway Oaks Drive, Suite 100
Sacramento, CA 95833

Dear Mr. Gilbert:

The State Controller's Office completed a quality control review of Gilbert Associates, Inc. We reviewed the audit working papers for the firm's audit of Berkeley Unified School District for the fiscal year ended June 30, 2002.

A revised draft report was issued on September 20, 2004. Your response to the revised draft report is included in this final report.

We have issued a separate final management letter dated February 11, 2005, included in this final report as Attachment 1.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

"original signed by"

VINCENT P. BROWN
Chief Operating Officer

VPB:JVB/ams

cc: Sheila Jordan, Superintendent
Alameda County Office of Education
Michele Lawrence, Superintendent
Berkeley Unified School District
Arlene Matsuura, Educational Consultant
School Fiscal Services Division
California Department of Education
Jeannie Oropeza
Program Budget Manager
Department of Finance

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Review Report

Summary

The State Controller's Office (SCO) completed a quality control review of the audit working papers for an audit performed by Gilbert Associates, Inc., of the Berkeley Unified School District for the fiscal year ended June 30, 2002 (FY 2001-02). Subsequent to the exit conference held August 25, 2003, the firm provided additional information in response to the draft report issued March 30, 2004. The SCO re-examined the firm's working papers and revised the draft report. The last day of fieldwork was May 26, 2004.

The audit referred to above was performed in accordance with the majority of the standards and requirements set forth in *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted government auditing standards (GAGAS); U.S. generally accepted auditing standards (GAAS); Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*; and the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO. However, the SCO reviewers noted one exception: noncompliance with K-12 Audit Guide reporting requirements.

Background

Any governmental unit subject to a single audit must have the audit performed in accordance with the standards referred to in this report. According to OMB Circular A-133, the auditor's work is subject to a quality control review at the discretion of an agency granted cognizant or oversight status by the federal funding agency. In addition, *Education Code* Section 14504.2 authorizes the SCO to perform quality control reviews of working papers for audits of K-12 local educational agencies (LEAs) to determine whether audits are performed in accordance with U.S. General Accounting Office standards for financial and compliance audits.

Berkeley Unified School District received a negative certification on its first interim budget report for FY 2002-03. *Education Code* Section 14504.2 requires the SCO to conduct a quality control review of the independent auditor who performed the audits of the school district for the prior three years. Gilbert Associates, Inc., performed the audit for FY 2001-02.

Gilbert Associates, Inc., is an independent certified public accounting firm with an office located in Sacramento, California. The firm performed 22 annual financial audits of LEAs for FY 2001-02. This is the first year the firm has been the independent auditor for Berkeley Unified School District. During FY 2001-02, the district operated eleven elementary schools, three junior high schools, two high schools, one adult education program, and one independent study program, with a total average daily attendance (ADA) of 10,633 for the purpose of state funding.

**Objectives,
Scope, and
Methodology**

The general objectives of the quality control review were to determine whether this audit was conducted in compliance with:

- GAGAS
- GAAS
- K-12 Audit Guide
- OMB Circular A-133

The quality control review was conducted at the office of Gilbert Associates, Inc. The SCO reviewers compared the audit work performed by the firm, as documented in the working papers, with the standards stated in the general objectives.

Conclusion

The audit referred to above was performed in accordance with the majority of the standards and requirements set forth in GAGAS, GAAS, OMB Circular A-133, and the K-12 Audit Guide. However, we noted one exception discussed in the Finding and Recommendation section of this report.

In conjunction with our review, we also issued a management letter. This letter describes a condition that, while not sufficiently material to include in this report, should be corrected by the firm.

This report is applicable solely to the audit working papers referred to above and is not intended to pertain to any other work of Gilbert Associates, Inc.

**Views of
Responsible
Official**

We issued a revised draft report on September 20, 2004. Thomas Gilbert responded via e-mail on November 5, 2004, disagreeing with the management letter. His response is included in this final report as Attachment 2.

Restricted Use

This report is intended solely for the information and use of the specified parties; it is not intended to be and should not be used for any other purpose. This restriction is not meant to limit distribution of the report, which is a matter of public record.

“original signed by”

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

Finding and Recommendation

General

The Single Audit Act and the *Standards and Procedures for Audits of K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO, require audits to be performed in accordance with U.S. generally accepted auditing standards (GAAS). These standards deal with the quality of the audits performed by the independent auditor and have been approved and adopted by the American Institute of Certified Public Accountants (AICPA). GAAS is divided into three areas: (1) general standards; (2) fieldwork standards; and (3) reporting standards. The three areas are divided into ten specific standards. In addition to GAAS, auditors of governmental entities must also perform audits in accordance with generally accepted government auditing standards (GAGAS), which expands the GAAS standards in several areas.

In the course of this quality control review, the SCO reviewers noted one exception with the K-12 Audit Guide reporting requirements.

Noncompliance With K-12 Audit Guide Reporting Requirements

FINDING— Reporting deficiency

The firm provided additional information in response to the original draft report finding. After reviewing the information, the SCO revised the finding as follows:

The firm did not report a \$1,239 discrepancy found during the testing of Morgan Hart Class Size Reduction Program in the audit report. The firm's working papers stated that the discrepancy "most likely was caused by a recalculation error." As documented in the working papers, "Basis for conclusion: immaterial and there was no non-compliance."

The firm's working papers lacked sufficient detail to support the conclusion reached by the firm. The working papers did not indicate the source of evidential matter or the documents reviewed or examined. The working papers stated that "Per review of supporting documentation it was determined that the actual number of English students were 696 and Soc. Std. was 719. Per discussion with [Instructional Services], it appears that the numbers were placed on the wrong line, and should have been switched." Our review of the Morgan-Hart submission form that was included in the working papers shows that 713 English students and 695 Social Studies students were claimed for funding purposes. The audited number of students that should have been claimed, or how it was determined that the numbers had been switched, was not supported by documents, spreadsheets, or any other documentation that substantiated the audited numbers or conclusion. Therefore, the working papers do not support the conclusion.

In addition, in a letter to the SCO dated April 22, 2004, the firm stated that the issue had been "...discussed with the district and that the district had decided that the cost/benefit did not justify amending the reported eligible pupils in the J-9MH-A form." The working papers documented the finding disposition as "verbal only." However, there was no documentation as to whom at the district this issue was discussed with, when this discussion occurred, or that it was actually the district's decision to pass and not revise the Morgan-Hart form in order to claim the additional funding due the district.

Education Code Section 41341(a)(2) states:

Notwithstanding paragraph (1), excesses may be withheld or deficiencies added to apportionments on account of audit exceptions in any fiscal year in which they are certified by the Superintendent of Public Instruction.

GAGAS 4.35 states:

Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

AU Section 339.01 states, in part that:

The auditor should prepare and maintain working papers. . . . The information contained in working papers constitutes the principal record of the work that the auditor has done and the conclusions that he has reached concerning significant matters.

AU Section 326.13 states in part that:

The evidential matter obtained should be sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements.

In addition, due professional care concerns what the auditor does and how well he/she does it. Due professional care imposes a responsibility upon each auditor to observe the standards of fieldwork and reporting, and critically review, at every level of supervision, the work done and the judgment exercised by those assisting in the examination. (AU Sections 230.02 and 230.04)

The CPA's conclusion may be impaired when based on insufficient and/or invalid evidential matter. All audit work should be properly documented and due professional care should be taken in conducting the audit. If the firm does not disclose such a finding, there exists the possibility that the district will lose funding it was actually due or the district will continue to make errors when completing claim forms.

Recommendation

As the firm believes the discrepancy was due to a recalculation error (a clerical discrepancy type error) and the finding would have brought the district additional funding it was actually eligible for, the firm should have reported the finding. As noted in *Education Code* Section 41341(a)(2), deficiencies may be added to apportionments on account of audit exceptions.

The firm should also follow all auditing standards with regards to documentation, and evidential matter supporting conclusions reached, as well as conduct the audit with due professional care.

Firm's Response

The firm did not respond to this finding.

Attachment 1— Management Letter



STEVE WESTLY
California State Controller

February 11, 2005

Mr. Thomas Gilbert
Gilbert Associates, Inc.
2880 Gateway Oaks Drive, Suite 100
Sacramento, CA 95833

Dear Mr. Gilbert:

During the State Controller's Office (SCO) quality control review of the audit working papers relating to the Gilbert Associates, Inc., audit of the Berkeley Unified School District for the fiscal year ended June 30, 2002, we noted a condition that should be brought to your attention.

We are providing this comment to assist the firm in fully complying with *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted government auditing standards (GAGAS); U.S. generally accepted auditing standards (GAAS); the requirements of the *Standards and Procedures for Audits of K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO; and the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Because the SCO's only intent is to inform you of this observation, you need not respond to the SCO regarding actions planned or taken on these matters. However, we believe that the firm should take action to correct this condition.

Our comment is based on circumstances that existed as of August 25, 2003, and does not reflect changes made subsequent to that date. The following comment is a condition noted during our review, along with a recommendation for improvement.

Gilbert Associates, Inc., did not perform adequate procedures to validate that deferred maintenance expenditures were consistent with the approved five-year deferred maintenance plan that was approved by the State Allocation Board.

Education Code Section 17591 states:

Each district desiring an apportionment pursuant to Section 17584 [for deferred maintenance] shall file with the State Allocation Board and receive approval of a five-year plan of the maintenance needs of the district over that five-year period. . . . Any expenditure of funds from the district deferred maintenance fund shall conform to the plan approved by the State Allocation Board.

Recommendation

Compliance audit procedures should be performed with sufficient attention toward complying with the *Education Code*. Sufficient resources should be allocated toward compliance areas to ensure that relevant procedures are properly completed.

Firm's Response

Your comment states that we “. . . did not perform adequate procedures to validate that deferred maintenance expenditures were consistent with the approved five-year maintenance plan. . . .” At the exit conference we pointed out that: we thoroughly documented our testing of specific compliance based on the K-12 audit guide requirements which did not set out any requirements for this program; that our control testing provided the necessary assurances for financial level compliance; and that there are literally hundreds (or may be even thousands) of compliance items in the Education Code that are not tested in the normal course of the annual audit. We rely on the K-12 audit guide and there is no support in the referenced audit standards (GAGAS, GAAS, K-12 Audit Guide, and OMB Circular A-133) to support this management letter comment.

SCO's Comment

Not every single compliance item in the *Education Code* is included in the K-12 Audit Guide. The K-12 Audit Guide contains suggested audit procedures for the testing of specific compliance requirements for certain programs. A prevailing objective of the K-12 Audit Guide's suggested audit procedures is a determination of compliance with the rules and regulations governing the programs listed. However, compliance testing is not limited specifically to only the programs listed in the K-12 Audit Guide. If a program or expenditure tested during an audit has compliance requirements, or other rules or regulations that must be followed, compliance with those requirements, rules, or regulations should not be ignored simply because they are not contained in the K-12 Audit Guide.

The K-12 Audit Guide, Section 110, “Purpose of the Audit Guide,” states, in part:

The State Controller's *Standards and Procedures for Audits of K-12 Local Educational Agencies* (audit guide) is designed to assist certified public accountants and public accountants in performing audits of K-12 local educational agencies (LEAs) and certain joint powers entities (JPEs). . . . It offers general insight into the nature and scope of the audit engagements, provide guidelines for the administration of the audits, and identifies the minimum audit and reporting requirements necessary to comply with statutory requirements. It is not intended to be a complete manual of procedures, nor is it intended to supplant the auditor's judgment.

The K-12 Audit Guide, Section 120, “Audit Objectives,” states, in part:

The general objectives of each audit are to determine whether . . . :

State and federal funds are being expended in accordance with the terms of applicable agreements and those provisions of law or regulations that could have a material effect on the financial statements or on the major programs tested.

The K-12 Audit Guide, Section 313, "Compliance with Laws and Regulations," states:

Government Auditing Standards require that "a test should be made of compliance with applicable laws and regulations."

Compliance testing includes tests performed to determine whether an entity is complying with the provisions of laws; regulations; and contractual, grant, loan, and other assistance agreements. The objectives of tests of compliance with laws and regulations are to determine whether there have been events of noncompliance that may have a material effect on the financial statements or to provide a basis for reporting on the entity's compliance with such laws and regulations.

In this case, if a deferred maintenance expenditure had been tested during the financial portion of the audit, it would still seem reasonable that one of the items or attributes being tested would be to ensure the expenditure was appropriate under the rules and regulations governing the deferred maintenance fund.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

"original signed by"

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB:ams

RE: S04-LEQ-005

**Attachment 2—
CPA's Response to Management Letter**

Cornell, Elizabeth

From: 'thom@gilbertcpa.com' [thom@gilbertcpa.com]
Sent: Friday, November 05, 2004 12:26 PM
To: Cornell, Elizabeth
Cc: Peggy A. Vande
Subject: re: QCR draft report

We do not believe that the SCO has any basis for the management letter referenced in the report. State compliance audit procedures are included in the annual audit guide and were all properly tested. To assert that we "...did not perform adequate procedures to validate that deferred maintenance expenditures were consistent with the approved five-year deferred maintenance plan...." is incorrect. The reliance on internal controls over expenditures, which were tested, is acceptable under all standards referenced in the report. To expect and/or require us to assure that "Any expenditure of funds from the district deferred maintenance fund shall conform" is unreasonable from an audit cost/benefit analysis and would impose a mandate by the state for the auditors to test specific transactions that may not be necessary. The SCO Quality Review Guide used in the review by your staff should be revised as follows: Page 30, Fund Requirements, 2. Deferred Maintenance, (a) Were any expenditures in internal control testing for deferred maintenance? If so, were they in accordance with the approved 5-year plan?

We would like the following included in the final report if the management letter is not deleted (taken from our 4/22/04 response to your first draft)

Your comment states that we "...did not perform adequate procedures to validate that deferred maintenance expenditures were consistent with the approved five-year maintenance plan..." At the exit conference we pointed out that: we thoroughly documented our testing of specific compliance based on the K-12 audit guide requirements which did not set out any requirements for this program; that our control testing provided the necessary assurances for financial level compliance; and that there are literally hundreds (or may be even thousands) of compliance items in the Education Code that are not tested in the normal course of the annual audit. We rely on the K-12 audit guide and there is no support in the referenced audit standards (GAGAS, GAAS, K-12 Audit Guide, and OMB Circular A-133) to support this management letter comment.

Thank you,
Thom

Thomas M. Gilbert
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